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C O N F I D E N T I A L SECTION 01 OF 02 KUALA LUMPUR 000048

STATE PASS USTR -- WEISEL AND BELL
STATE PASS FEDERAL RESERVE AND EXIMBANK
STATE PASS FEDERAL RESERVE SAN FRANCISCO TCURRAN
SINGAPORE PASS TO SBAKER
USDOC FOR 4430/MAC/EAP/M.HOGGE
TREASURY FOR OASIA AND IRS
GENEVA FOR USTR
SIPDIS

E.O. 12958: DECL: 01/23/2019
TAGS: ECON EFIN EINV ETRD PGOV MY IN
SUBJECT: MALAYSIA: ALL SIGNS POINT TOWARD RECESSION

REF: A. 2008 KUALA LUMPUR 901
¶B. 2008 KUALA LUMPUR 1080

Classified By: Deputy Chief of Mission Robert G. Rapson for reasons 1.4 (b) and (d)

¶1. (SBU) SUMMARY AND COMMENT: Although the Government of Malaysia has not offered a public statement revising its official forecast of 3.5 percent GDP growth for 2009, its actions speak louder than its words. On January 21 the central bank, Bank Negara Malaysia, slashed interest rates by 75 basis points, surprising analysts who had forecast a 25 or 50 point cut. Most analysts' GDP growth predictions have ranged from zero to two percent for this year, but in private bankers say recession is inevitable. Other signs pointing downward include a projected reduction in 2009 auto sales of 12.4 percent and a GOM ban on new foreign unskilled and semi-skilled workers in anticipation of layoffs of Malaysians. The GOM continues to downplay Malaysia's economic problems in an effort to boost -- or at least not undermine -- confidence, but GOM policy actions indicate the government,s internal views match bankers' private forecasts that the economy is headed into recession. End summary and comment.

CENTRAL BANK DROPS INTEREST RATES BY 75 POINTS

¶2. (SBU) In a move that surprised most analysts, Bank Negara Malaysia (BNM) dropped its overnight policy rate (OPR) by 75 basis points to 2.5 percent on January 21, the biggest drop since 2004. The statutory reserve requirement (SRR) will be lowered from 3.5 to 2.0 percent effective February 1st. BNM called this a "pre-emptive" measure which would "be key towards ensuring that the Malaysian economy continues to experience positive growth in 2009." Malaysia's most recent reduction in the OPR was a 25-point cut on November 24.

EFFORTS TO PUSH BANKS TO LEND ARE INEFFECTIVE

¶3. (C) Naser Jafar, Vice President and Country Executive for Bank of America Malaysia, told Econ Counselor that this move was likely designed to push banks to lend. BNM fixes interest on deposit accounts at 3 percent; therefore banks placing deposits with the central bank at 2.5 percent would incur losses. By making loans, they could earn approximately 6 percent. But banks remained reluctant to lend without knowing "where the bottom was" in the economic fallout, he explained. Would companies fold, property rates drop, and workers lose their jobs? It was a risky market in which to

lend for local banks and many foreign companies simply were sending capital back to headquarters. In many cases, that capital was sorely needed at home.

FURTHER RATE CUTS PREDICTED; GOM WORRIED

¶4. (SBU) In its publication to shareholders Citigroup predicted further cuts in the OPR to below 2 percent by the end of 2009, pointing out that lower revenues from Malaysia's crude oil exports would result in a larger fiscal deficit than expected; therefore, there would be less space for fiscal policy and the GOM would rely more on monetary policy to stimulate the economy.

RECESSION "DEFINITE," SAYS BANKER

¶5. (C) In private, Citibank economists were pessimistic about the Malaysian economy. Kuldeep Singh, Citibank Malaysia's Director & Country Treasurer, said the 75 basis-point cut was further evidence that the GOM was "spectacularly worried" about the prospect of recession and explained that the government analysts looked "almost entirely" to the U.S. market to forecast Malaysian economic prospects. Foreign exchange and exports were falling day by day, he said. Naser Jafar told Econ Counselor that he believed Malaysia was headed into a recession, hitting the bottom at about mid-2009 before beginning to recover. Sanjeev Nanavati, Citibank Malaysia's Managing Director, told Econ Counselor he felt that a recession was "definite." He scoffed at the central bank's forecast of 3.5 percent growth for 2009.

GOM STIMULUS PACKAGES INSUFFICIENT, INEFFECTIVE

¶6. (C) Nanavati told Econ Counselor that Malaysia's first economic stimulus package of RM 7 billion (USD 2 billion) had been entirely ineffective. First, it was too small to have an impact and second, it was aimed at long-term gains when what was needed was a short-term stimulus. Much of the first package went toward co-funding of training for workers, increasing productivity, and measures designed to keep people in jobs. Some infrastructure projects would begin by the end of March, Nanavati said, but on the ground, "nobody feels it, nobody believes it, and some people think it just went to line someone else's pocket."

¶7. (C) A second stimulus package was in the works which Nanavati expected to have more impact because the GOM had consulted the business community (including Citibank) about what to include. It was unlikely that the GOM would cut individual taxes because Malaysians would likely save 70% of every dollar. Singh said the best way to stimulate the economy would be to improve the social safety net; when people were afraid they would go hungry if they lost their jobs, they were unwilling to spend. Unfortunately, this was not on the table. Also not included was any plan to stimulate domestic demand; the GOM considered this "irresponsible," Nanavati explained, saying that the GOM saw its role as building bridges and other infrastructure projects, regardless of the problem of "leakage." Two useful measures that could be included in a second stimulus package were a decrease in corporate taxes and accelerated depreciation of capital assets, they said. This would enable companies to keep from closing their doors, but the benefits would not be felt until September at the earliest and would only help stabilize, not lift, the economy. Ultimately, what would go into the second stimulus package would be based on political expediency, Nanavati said.

OTHER SIGNS

¶9. (SBU) More signs pointing downward include an announcement by the Malaysian Automotive Association that auto sales were expected to drop by 12.4 percent in 2009, after strong sales

in the first three quarters of 2008. In anticipation of more than 100,000 layoffs, the GOM announced that unskilled and semi-skilled new foreign workers would not be allowed to enter Malaysia unless a company could make a strong case that locals were not available to fill jobs. Nanavati pointed to India where he had learned on a recent visit that manufacturers were filling current orders but in many cases no new orders were coming in. He anticipated large-scale layoffs over the next month or two in India, and said this was an indicator of a massive dropoff in global demand that would hit Malaysia, an export-driven economy, hard.
KEITH